

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

ARNOLD KREEK, individually and on  
behalf of all others similarly situated,

Plaintiff,

v.

WELLS FARGO & COMPANY, WELLS  
FARGO FUNDS MANAGEMENT, LLC,  
WELLS FARGO FUNDS TRUST, WELLS  
FARGO DISTRIBUTORS, STEPHENS,  
INC., and WELLS FARGO BANK, N.A.,

Defendants.

No. C 08-01830 WHA

**ORDER DISMISSING  
CLASS ALLEGATIONS ONLY**

**INTRODUCTION**

In this proposed class action, this is a motion to dismiss claims involving defendants' alleged violation of federal securities laws. Plaintiff investors assert that defendants Wells Fargo & Company and its affiliates violated Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934. On this motion to dismiss, defendants argue that plaintiffs' claims are untimely under the two-year statute of limitations and that the complaint fails to properly plead a violation of Rule 10b-5. This order finds that all putative class members were on inquiry notice more than two years before the action was filed. The statute of limitations for the *individual* claims was tolled by the filing of *Ronald Siemers v. Wells Fargo*. The *class* allegations, however, were not tolled by *Siemers*. Accordingly, plaintiffs may continue this action as individuals but

1 the class allegations must be dismissed. The complaint otherwise states a valid claim for relief.  
2 Defendants' motion to dismiss plaintiffs' individual claims is **DENIED**.

### 3 **STATEMENT**

4 This is a putative class action that arises from allegations of false and misleading  
5 statements in violation of federal securities laws. Plaintiffs Edward Lee, Edward Arsenault,  
6 Emil De Bacco, Richard Hinton, Arnold Kreek, and Margret Macht are investors who  
7 purchased Wells Fargo Funds from November 4, 2000, through April 11, 2006, inclusive.  
8 Defendants Wells Fargo & Company and its affiliates (Wells Fargo Funds Management, LLC,  
9 and Wells Fargo Funds Trust) provide financial services to clients — such as banking, insurance,  
10 investments, mortgage, and consumer finance services.

11 Plaintiffs allege that defendant Wells Fargo & Company is the ultimate parent of all  
12 defendants named in the complaint. It was the ultimate beneficiary of the scheme to drive new  
13 investors into the Wells Fargo funds through the alleged kickback scheme. Defendant Wells  
14 Fargo Funds Management, LLC, is registered as an investment adviser under the Investment  
15 Advisers Act and is allegedly responsible for implementing the policies and guidelines for the  
16 funds at issue. Wells Fargo Funds Trust is allegedly the registrant of all the Wells Fargo funds  
17 for purposes of filing financials with the SEC.

18 Plaintiffs allege that Wells Fargo and its affiliates entered into secret revenue-sharing  
19 agreements with brokerages and selling agents who sold Wells Fargo Funds. Brokerages and  
20 selling agents received revenue when they steered their clients into Wells Fargo Funds to the  
21 exclusion of other funds better suited to their clients' interests. Defendants financed these  
22 improper kickbacks by charging hidden excessive fees to their clients, which fees should have  
23 instead been invested in the funds' underlying portfolio. These preexisting and ongoing  
24 revenue-sharing arrangements were not disclosed to investors at the time investors purchased  
25 Wells Fargo Funds.

26 From 2000 to 2006, plaintiffs each purchased shares in at least one of defendants'  
27 mutual funds. Annually, each fund issued a prospectus that contained a disclosure pertaining  
28 to the fund's "Fund—Objective—Principal Strategy," "Shareholder Fees" and "Annual Fund

1 Operating,” “Organization and Management of the Funds,” and “Distribution Plan.”  
2 A “Statement of Additional Information” (SAI) also was included with each prospectus  
3 that discussed the duties of the investment advisor, investment sub-advisors, administrators,  
4 distributor, and custodian and the fees to which they were entitled. The SAIs also provided  
5 information regarding defendants’ shareholder-servicing plan and shareholder-servicing agents  
6 as well as its rule 12b-1 plan. In 2002, 2004, and 2005, supplemental information regarding  
7 “Additional Payments” was also included in the prospectuses. Plaintiffs allege that the  
8 prospectuses and SAIs, released from 2000 to 2006 were false and misleading in identical  
9 respects. Generally, those documents did not disclose the secret revenue-sharing agreements.  
10 Plaintiffs argue that if the kickback payments pursuant to the revenue-sharing agreements had  
11 been disclosed to investors at the time the investments were made, no reasonable investor would  
12 have invested in the funds.

13 This action is a sequel to a previous and heavily litigated action entitled *Ronald Siemers v.*  
14 *Wells Fargo*, C 05-04518-WHA, which was before the undersigned until it settled on a class-wide  
15 basis on August 3, 2007.

16 On April 4, 2008, the same counsel filed this action on behalf of different investors  
17 but assert the same theories as to all the Wells Fargo funds that were not certified in *Siemers*.  
18 Plaintiffs allege that the investment adviser and registrant adviser defendants violated  
19 Section 10(b) of the Exchange Act and Rule 10b-5 by employing a revenue-sharing scheme  
20 which they intended to use to defraud plaintiffs; by disseminating materially false and misleading  
21 information through the instrumentalities of interstate commerce; that it profited from these  
22 unlawful fees that it charged plaintiffs; had actual knowledge of the misrepresentations and  
23 omissions of material facts; that plaintiffs did not have knowledge of the falsity of the  
24 misrepresentations or omissions; and that plaintiffs as a direct and proximate result of defendants’  
25 conduct were harmed. Plaintiffs also allege that Wells Fargo & Company violated Section 20(a)  
26 of the Exchange Act because it acted as a controlling person of the investment adviser and  
27 registrant adviser defendants; investment adviser and registrant advisor defendants violated  
28

1 Section 10(b) and Rule 10b-5; and as a direct and proximate result of investment advisor and  
2 registrant advisor's conduct, plaintiffs were harmed.

### 3 ANALYSIS

#### 4 1. LEGAL STANDARD.

5 A motion to dismiss under Rule 12(b)(6) tests the legal sufficiency of the claims alleged  
6 in the complaint. The Supreme Court has recently explained that "[t]o survive a motion to  
7 dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to  
8 relief that is plausible on its face." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (citations  
9 omitted). "A claim has facial plausibility when the plaintiff pleads factual content that allows  
10 the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."  
11 *Ibid*. All material allegations in the complaint as well as reasonable inferences to be drawn  
12 from them are accepted as true. But this does not apply to legal conclusions. Rather, courts must  
13 examine whether conclusory allegations follow from the description of facts as alleged by the  
14 plaintiff.

15 Although materials outside of the pleadings should not be considered without converting  
16 the motion to dismiss to a motion for summary judgment, a district court may consider all  
17 materials properly submitted as part of the complaint such as exhibits. A district court may also  
18 consider documents to which the complaint specifically refers and whose authenticity is not  
19 questioned even if they are not physically attached to the complaint. A district court may take  
20 judicial notice of its own orders and of records in a case before it as well as other matters of  
21 public record that are properly subject to judicial notice. *Hal Roach Studios v. Richard Feiner*  
22 *and Co., Inc.*, 896 F.2d 1542, 1555 n.19 (9th Cir. 1990).

23 In this case, this order involves a review of documents essential to the claim, documents  
24 specifically referred to in the complaint, documents already in the Court's files, and published  
25 reports regarding the payment of hidden brokerage fees by mutual fund companies including  
26 affiliates of defendants in this case.

1           **2.       STATUTE OF LIMITATIONS.**

2           Claims for a violation of Section 10(b) and Section 20(a) of the 1934 Act must be brought  
3 within two years of discovery of the facts constituting a violation. 28 U.S.C. 1658(b)(1).

4           “[E]ither actual or inquiry notice can start the running of the statute of limitations on a federal  
5 securities fraud claim.” *Betz v. Trainer Wortham & Co., Inc.*, 519 F.3d 863, 869 (9th Cir. 2008).

6           The Ninth Circuit uses the “inquiry-plus-reasonable-diligence” test to determine whether  
7 a statute of limitations begins running due to inquiry notice. This is a two-part objective test.  
8 *First*, a court must determine whether the plaintiff had inquiry notice of the facts giving rise to  
9 his claim. The *Betz* decision held that the facts constituting inquiry notice “must be sufficiently  
10 probative of fraud — sufficiently advanced beyond the stage of a mere suspicion to incite the  
11 victim to investigate.” *Id.* at 871. *Second*, a court must ask whether “the investor, in the exercise  
12 of reasonable diligence, should have discovered the facts underlying the alleged fraud.” *Id.* at  
13 876 (citation omitted). Under this standard, the defendant bears a considerable burden in  
14 demonstrating that the plaintiff’s claim is time barred. A ruling as a matter of law is appropriate  
15 “only when uncontroverted evidence irrefutably demonstrates plaintiff discovered or should have  
16 discovered the fraudulent conduct.” *Id.* at 877 (citation omitted).

17           **A.       Inquiry Notice.**

18           *In re American Funds Securities Litigation*, 556 F. Supp. 2d 1100 (C.D. Cal. 2008), is  
19 directly on point. That decision dismissed a complaint involving an alleged violation of  
20 Section 10(b) as time barred after finding that the plaintiff investors were on inquiry notice of  
21 the defendant’s alleged misconduct. The decision found that news articles, SEC press releases,  
22 and a prior complaint filed by other investors were sufficient to put the plaintiffs on inquiry  
23 notice. One such news article published by the Los Angeles Times, “focus[ed] on the activities  
24 of the defendants named in [that] case and on the same payments that [were] the center of their  
25 alleged wrongdoing.” *Id.* at 1105–06. The article was held to establish “sufficient suspicion of  
26 fraud to cause a reasonable investor to investigate the matter further because it report[ed] that one  
27 of the brokerages receiving such payments . . . agreed to pay \$50 million to settle SEC charges  
28

that it had received substantial hidden fees” from numerous companies in return for promoting their funds. *Ibid.*

The district court in *American Funds* also noted a prior complaint filed over two years before the complaint at issue and which alleged “a nearly identical scheme of wrongdoing against [d]efendants.” The decision held that the prior complaint “when taken together with all of the other information in the public domain regarding investigations into” revenue sharing between mutual fund companies “would have put anyone giving reasonable attention to the subject on notice of the existence of a claim under the 1933 and 1934 Acts.” *Id.* at 1109–10.

The facts in the present case are nearly identical to those in *American Funds*. This order takes notice of the NASD’s June 2005 press release, the news articles which carried that press release, the prior decision in *Siemers*, and the December 2005 “Disclosure Statement” issued by Wells Fargo. These documents put plaintiffs on inquiry notice by December 2005. They were “sufficiently probative of fraud — sufficiently advanced beyond the stage of a mere suspicion . . . to incite the victim to investigate.” *Betz*, 519 F.3d at 871.

Plaintiffs admit to the NASD’s June 2005 press release in their complaint. The complaint alleges that as detailed in the NASD’s press release the:

NASD found that the [Wells Fargo Investments], most of which sold funds offered by hundreds of different mutual fund complexes, operated “preferred partner” or “shelf space” programs that provided certain benefits to a relatively small number of mutual fund complexes in return for directed brokerage. The benefits to mutual fund complexes of these quid pro quo arrangements included, in various cases, higher visibility on the firms’ internal web sites, increased access to the firms’ sales forces, participation in “top producer” or training meetings, and promotion of their funds on a broader basis than was available for other funds.

(Compl. ¶ 246). The press release further asserted that the fund complexes “use[d] assets of the mutual funds instead of their own money to meet the[se] revenue sharing obligations” (Wells Fargo Exh. A at 1). Contrary to plaintiffs’ assertion, the release specifically stated that Wells Fargo Investments, an affiliate of Wells Fargo & Company, was fined \$2,970,000 for its involvement in the scheme (*ibid.*). The story was carried by major media outlets including the *Los Angeles Times*, *Associated Press*, *MarketWire*, and *PR Newswire*.

1 Plaintiffs also rely upon Wells Fargo's December 2005 "Disclosure Statement" in their  
2 complaint. That document stated that Wells Fargo participated in revenue-sharing agreements  
3 and that the "compensation arrangements [were] in addition to the sales charges and fees that  
4 [were] disclosed in the fee tables, prospectuses and statements of additional information"  
5 (Compl. ¶247). According to the complaint, "Wells Fargo Investments admitted that it received  
6 the payments from the Wells Fargo Funds that are at issue in this Complaint, that said payments  
7 created potential conflicts of interest and that, finally, such payments were not disclosed in  
8 either the Wells Fargo Funds' prospectuses or statements of additional information" (*ibid.*).  
9 Other similarly situated investors in the *Siemens* case alleged that "the full extent of  
10 [d]efendants' conflicts of interests were revealed" when the disclosure statement was "publicly  
11 circulated" in December 2005 (Wells Fargo Exh. Y). Moreover, the complaint alleges this  
12 information under the heading "The Truth Begins to Be Disclosed." In relying on the disclosure  
13 statement in their complaint, plaintiffs have practically conceded that they were on inquiry notice  
14 as of December 2005.

15 Finally, plaintiffs allege that their complaint is premised on the *Siemens* action.  
16 The *Siemens* action affirms the finding that plaintiffs were on inquiry notice more than two  
17 years before the filing of this action. The first *Siemens* complaint was filed in November 2005  
18 and contained substantially similar allegations of fraud against the same defendants as here.  
19 Contrary to plaintiffs' assertion, it alleged the same core allegations as here, including  
20 allegations of defendants' violation of Section 10b-5 of the 1934 Act and allegations of scienter  
21 (Wells Fargo Exh. Z). The *Siemens* complaint was first publicized in *PR Newswire* and the  
22 *Associated Press* on November 11 and was later carried at least 19 additional times by *PR*  
23 *Newswire* (Wells Fargo Exh. D-W). It was also filed with the SEC in December 2005 (Wells  
24 Fargo Exh. FF). As in *American Funds*, "when taken together with all of the other information  
25 in the public domain" regarding the revenue-sharing scheme, the previously-filed *Siemens*  
26 complaint "would have put anyone giving reasonable attention to the subject on notice of the  
27 existence of a claim" under the 1934 Act. *American Funds*, 556 F. Supp. 2d at 1109-10.



**B. Reasonable Diligence.**

With regard to the second prong of the test for inquiry notice, plaintiffs argue that what a reasonable investor should have known is particularly suited to a jury determination and that the issue of diligence is difficult to resolve as a matter of law. While these contentions are correct, the relevant question is “whether their application in this case on this record defeats the motion to dismiss.” *American Funds*, 556 F. Supp. 2d at 1110. In fact, there are numerous decisions where plaintiffs were found to be on inquiry notice as a matter of law on a motion to dismiss. *See, e.g., In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399 (9th Cir. 1996); *American Funds*, 556 F. Supp. 2d 1100; *In re Infonet Servs. Corp. Sec. Litig.*, 310 F. Supp. 2d 1106 (C.D. Cal. 2003); *DeBenedictis v. Merrill Lynch & Co., Inc.*, 492 F.3d 209 (3rd Cir. 2007).

In this case, the inquiry notice and reasonable diligence tests merge because of the level of detail that was disclosed by December 2005. As stated, the NASD action, press releases, and disclosure statement revealed that Wells Fargo affiliates had participated in revenue-sharing agreements paid from fund assets not earlier disclosed in its prospectuses or SAIs. This was and is the crux of the allegations in the complaint here and in *Siemers*. The public record by December 2005 contained information that not only put plaintiffs on notice of fraud, but also exposed how the revenue-sharing scheme worked. The fact that other similarly situated plaintiffs were able to file an identical action in *Siemers* by November 2005 affirms this order’s finding that plaintiffs were on inquiry notice more than two years before the complaint was filed in April 2008. Thus, absent tolling, the two-year statute of limitations ran on these claims before this action was commenced.

**3. TOLLING.**

Plaintiffs argue that the statute of limitations was tolled by the filing of the *Siemers* complaint. This order finds that the statute of limitations was tolled with respect to the *individual* plaintiffs in this action. The statute of limitations was not tolled, however, for the *class* allegations.

In *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), the plaintiffs filed a class action suit with only eleven days left to run on the applicable statute of limitations.



1 Class certification was later denied, and eight days after that a number of individual class  
 2 members moved to intervene as individuals. The Supreme Court ruled that the filing of a class  
 3 action tolled the statute of limitations for all plaintiffs who filed timely motions to intervene.  
 4 In *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983), the Supreme Court extended  
 5 *American Pipe* tolling to all asserted members of the class who sought to file new but individual  
 6 actions following a denial of class certification — not just to intervenors in the original class  
 7 proceeding.

8 While the Supreme Court has not yet considered whether *American Pipe* tolling applies  
 9 to subsequent *class* claims following the denial of class certification, the appellate courts have  
 10 generally refused to extend the tolling doctrine in most circumstances. The Ninth Circuit  
 11 considered this question in *Robbin v. Fluor Corp*, 835 F.2d 213 (9th Cir. 1987). It held:

12 Robbin asserts that the policy considerations underlying the tolling  
 13 doctrines of *American Pipe* and *Crown, Cork* should be extended  
 14 to include class members who file subsequent class actions. This  
 15 position has been squarely rejected by several courts . . . We agree  
 16 with the Second Circuit that to extend tolling to class actions “tests  
 the outer limits of the *American Pipe* doctrine and . . . falls beyond  
 its carefully crafter parameters into the range of abusive options.”  
 We therefore affirm the district court’s dismissal of *Robbin*’s class  
 action.

17 *Ibid* (citing *Korwek v. Hunt*, 827 F.2d 874 (2nd Cir. 1987)). The reasoning, as stated by *Korwek*,  
 18 was that putative class members may *not* “piggy-back one class action onto another and thus toll  
 19 the statute of limitations indefinitely.” *Id.* at 878.

20 In *Catholic Social Services, Inc. v. INS*, 232 F.3d 1139 (9th Cir. 2000), the Ninth Circuit  
 21 again considered the question of whether *American Pipe* tolling applies to subsequent class  
 22 claims following the denial of class certification. This time it cut out a narrow exception to  
 23 *Robbin*. In *Catholic Social Services*, the plaintiffs in a prior action filed a class action claim.  
 24 After the class had already been certified, Congress stripped federal courts of jurisdiction over  
 25 the named plaintiffs in that action. A new class action was filed with named plaintiffs that met  
 26 the new jurisdictional requirements. Even though the statute of limitations had run, the decision  
 27 tolled the statute of limitations for the subsequent class action. The Ninth Circuit, however,  
 28 re-affirmed *Robbin*. *Catholic Social Services* was careful to reiterate its holding that *American*

1 *Pipe* tolling does not apply when the plaintiffs are “attempting to relitigate an earlier denial of  
2 class certification or to correct a procedural deficiency in an earlier would-be class.” *Id.* at 1149.

3 Here, plaintiffs are attempting exactly what *Robbin* and *Korwek* foreclosed — they are  
4 attempting to relitigate an earlier denial of class certification in *Siemers*. *Korwek* is directly on  
5 point. That decision involved plaintiffs who had previously filed a lawsuit alleging a broad  
6 class. In the prior action, a class certification order had “drastically limited the scope of the class  
7 certified largely because of what it adjudged to be significant problems of manageability,”  
8 among other reasons. In *Korwek*, those plaintiffs who were denied certification in the prior  
9 action filed a subsequent class action which asserted “claims virtually identical to those  
10 previously asserted in [the prior action] and name[d] nearly all of the same parties as  
11 defendants.” The decision in *Korwek* held that the statute of limitations did not toll for the  
12 subsequent class action.

13 Here, as in *Korwek*, *Siemers* was filed as a broad class consisting of purchasers of more  
14 than seventy Wells Fargo mutual funds. *Siemers* eventually certified a narrower class consisting  
15 of only the purchasers of the mutual funds held by the lead plaintiff — three funds in all. In the  
16 present case, like in *Korwek*, a new group of lead plaintiffs are attempting to cure the  
17 deficiencies in the prior action. Plaintiffs seek to certify the same class that *Siemers* had already  
18 found inappropriate for certification. The similarities between the two actions are readily  
19 apparent. *First*, as in *Siemers*, the proposed classes consist of purchasers of approximately  
20 seventy Wells Fargo mutual funds. *Second*, the proposed class period extends for nearly the  
21 same length as that in *Siemers* — from November 2000 through April 2006.<sup>1</sup> *Third*, plaintiffs  
22 bring the exact same claims and legal theories as those raised in *Siemers*. Indeed, the first page  
23 of the complaint states that it is premised on the Third Amended Complaint in the *Siemers*  
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26  
27 <sup>1</sup> The proposed class period in the present action extends five months longer than in *Siemers* due to  
28 plaintiffs’ allegations that Wells Fargo did not cease its illegal practices until a few months after the filing of the  
*Siemers* action. This is insignificant. For all intents and purposes, the proposed class periods for the two  
actions are identical.

1 action. As in *Korwek*, the present case reduces to an attempt to relitigate the prior denial of class  
2 certification in *Siemers*.<sup>2</sup>

3 *American Pipe* tolling cannot be extended to allow plaintiffs in this case to relitigate the  
4 earlier denial of class certification. The class allegations are therefore time-barred. But the  
5 statute of limitations was tolled for the individual plaintiffs pursuant to *American Pipe*.  
6 Accordingly, those plaintiffs may proceed in this action as individual plaintiffs.

#### 7 **4. SUFFICIENCY OF THE COMPLAINT.**

8 Defendants challenge the sufficiency of the complaint on multiple grounds. They argue  
9 that the complaint fails to properly allege that the purported omissions and misrepresentations  
10 were material, that the complaint fails to adequately plead reliance, that the complaint fails to  
11 adequately plead scienter, that the complaint fails to plead the *Gartenburg* factors with  
12 particularity, and that the complaint fails to adequately plead causation. Each of defendants'  
13 challenges were considered and rejected by *Siemers*. Given that the complaint in the present  
14 action is nearly identical to the complaint that survived these same attacks in *Siemers*, this order  
15 finds that the complaint is well beyond the threat of a Rule 12(b) dismissal.

#### 16 **A. Materiality of Defendants' Omissions.**

17 Defendants argue that plaintiffs fail to allege the materiality of any statements or  
18 omissions with sufficient particularity "as to any plaintiff, any prospectus, or any purchase or  
19 sale of any Wells Fargo Fund." This argument is rejected.

20 To prevail on a 10b-5 claim, plaintiffs must allege with particularity that the statements  
21 or omissions at issue were misleading as to material facts. *Basic Inc. v. Levinson*, 485 U.S. 224,  
22 238 (1988). A statement is material only if "there is a substantial likelihood that the disclosure  
23 of the omitted fact would have been viewed by a reasonable investor as having significantly  
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25  
26 <sup>2</sup> Plaintiffs attempt to distinguish this action on the grounds that the new class is comprised of nine  
27 subclasses. This argument fails. They do not cite any Ninth Circuit authority where a subclass was tolled under  
28 *American Pipe*. Furthermore, the proposed subclasses are the exact same size and scope as the proposed class  
in *Siemers*. The same manageability concerns exist. Calling the proposed class different than that in *Siemers* is  
a smoke-and-mirrors argument. This action is an attempt to relitigate the prior denial of class certification.

1 altered the total mix of information made available.” *Miller v. Thane Int’l. Inc.*, 519 F.3d 879  
 2 (9th Cir. 2008).

3 Here, the complaint alleges that Wells Fargo made \$350 million in secret kickback  
 4 revenue-sharing payments during the class period. This was material. These secret payments  
 5 exemplify the principal wrong — that the fees were not being used for their stated purposes.  
 6 The payments not only shrank plaintiffs’ investments but they also created conflicts of interest  
 7 that any investor would want to know about before deciding to invest in Wells Fargo mutual  
 8 funds. As *Siemers* reasoned:

9 The defense insists that unless we know the extent of the excess,  
 10 we cannot tell whether the amounts would have been material.  
 11 Maybe, they suggest, the excess was tiny. We must not forget that  
 12 defendants themselves refer to the payments at issue as  
 13 “significant.” This was set forth in most of the prospectuses at  
 14 issue. Although those disclosures were allegedly inadequate in  
 15 multiple ways, they repeatedly referred to the payments as  
 16 “significant.” Defendants may not walk away from these  
 17 admissions. Moreover, any intentional misappropriation from the  
 18 common fund would have been material to investors. The integrity  
 19 of management is always of importance to investors. That a  
 20 fiduciary has been misappropriating the common fund — even in  
 21 small amounts — would be important to investors, for the next  
 22 misappropriation or defalcation could be larger. Intentional  
 23 misappropriation would always be a red flag, a negative factor of  
 24 material interest to investors.

25 *Siemers*, 2007 WL 1140660, at \*8. That reasoning still stands. Accordingly, the complaint  
 26 alleges materiality with adequate particularity.

### 27 **B. Reliance.**

28 To adequately plead reliance in a 10b-5 claim, plaintiffs must “prove that the alleged  
 misrepresentations induced them to do something different from what they would otherwise  
 have done in making investment decisions.” *In re Nations Mart Corp. Sec. Lit.*, 130 F.3d 309,  
 321 (8th Cir. 1998). Generally, the complaint must plead individual reliance by the plaintiffs.  
 But the Supreme Court recognized an exception to this rule in *Affiliated Ute Citizens of Utah v.*  
*United States*, 406 U.S. 128 (1972). That decision permitted a presumption of reliance where the  
 defendant omitted material information from its communications with the plaintiff. It held that,  
 in those circumstances, “proof of reliance is not a prerequisite to recovery. All that is necessary

1 is that the facts withheld be material in the sense that a reasonable investor might have  
2 considered them important in the making of this decision.” *Id.* at 153–54.

3 Here, the action falls within the *Ute* exception. *Siemers* again is directly on point.  
4 That decision held:

5 Movant’s argument conflicts with the express command of the  
6 Supreme Court in *Affiliated Ute Citizens of Utah*, which held that  
7 “positive proof of reliance is not a prerequisite” when the case  
8 involves “primarily a failure to disclose,” not exclusively a failure  
9 to disclose. This order holds that plaintiff need not make  
10 independent allegations of reliance because he adequately pleads  
11 causation by accusing defendants of material omissions resulting  
12 in half truths.

13 *Siemers*, 2006 WL 2355411, at \*11. The facts are the same here. As stated, defendants’  
14 material omissions, the secret revenue-sharing agreements, resulted in half truths for the  
15 purposes of *Ute*. Accordingly, the complaint adequately pleads reliance.

### 16 C. Scierter.

17 To plead the requisite facts for scierter, a complaint must allege that the defendant made  
18 false or misleading statements either intentionally or with deliberate recklessness. In 2007, the  
19 Supreme Court explained that the PSLRA requires a stringent pleading standard for scierter.  
20 *Tellabs Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007). It held that the complaint  
21 “must plead facts rendering an inference of scierter at least as likely as any plausible opposing  
22 inference.” *Id.* at 2513. The Ninth Circuit has reasoned that the *Tellabs* standard requires a  
23 plaintiff to “plead a highly unreasonable omission . . . which presents a danger of misleading  
24 buyers or sellers that is either known to the defendant or is so obvious that the actor must have  
25 been aware of it.” *Zucco Partners, LLC v. Digimarc Corp.*, \_\_\_ F.3d \_\_\_, 2009 WL 57081,  
26 at \*6 (9th Cir. Jan. 12, 2009).

27 The complaint adequately pleads scierter within the standard set forth in *Tellabs*.  
28 Wells Fargo and its key officers knew about its secret revenue-sharing program. They knew  
it was inadequately disclosed in the prospectuses. These secret agreements were part of a  
persistent and deliberate scheme to use half truths to conceal a thriving system of kickbacks.  
Moreover, those inadequate disclosures were not the result of simple, or even inexcusable

1 negligence. The way in which the secret program was buried in the prospectus indicates that  
2 defendants deliberately chose to hide it from the investors. As recognized in *Siemers*, “[t]hat  
3 they went to some trouble to allude to [the agreements] in vague and incomplete language and  
4 buried the passages in unexpected placements indicates that they knew of its significance, yet  
5 chose to mislead.” *Siemers*, 2007 WL 1140660, at \*12. These facts raise a strong inference of  
6 intentional misleading by defendants on a “material investment decision.”

7 **D. Gartenburg factors.**

8 Defendants argue that plaintiffs fail to allege with particularity that the fees were  
9 excessive under *Gartenburg v. Merrill Lynch Asset Management*, 694 F.2d 923 (2nd Cir.  
10 1982). But *Gartenburg* does not require those factors to be proved at the pleading stage.  
11 Defendants have not identified any decisions to the contrary. Indeed, *Siemers* recognized  
12 that “there is no requirement that the *Gartenburg* factors be pled and no decision so holds.  
13 That decision came after a full trial and was not a pleading case. Moreover, it involved  
14 Section 36(b), not the 1933 and 1934 Acts.” *Siemers*, 2007 WL 760750, at \*13 (citing  
15 *Gartenburg*, 694 F.2d 923). Defendants go through great lengths to explain what must be  
16 proven at trial. But this is not at issue. Their argument fails.

17 **E. Causation.**

18 Damages in Rule 10b-5 claims are limited to cognizable economic losses that are  
19 attributed to the fraud of the defendant. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 346 (2005).  
20 The complaint pleads that at a minimum plaintiffs’ losses were equal to the money taken from  
21 the mutual fund to pay for the secret revenue-sharing agreements. This is adequate for the  
22 pleading stage.

23 Defendants argue that loss causation damages are adequate only if the plaintiff alleges  
24 that the defendants’ fraud caused the value of the securities to drop. Their reliance on *Dura* is  
25 inapposite. That decision merely stands for the proposition that “a plaintiff must prove that the  
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1 defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's  
2 loss." *Dura*, 544 U.S. at 346. As *Siemers* explained:

3 One measure of loss causation approved by the Supreme Court  
4 was the familiar story of a plummet in the share price after the  
5 truth became known. That, however, was only one way to plead  
6 loss causation, not the only way. The Supreme Court stated that  
7 "ordinary pleading rules are not meant to impose a great burden  
8 upon a plaintiff" and that "it should not prove burdensome for a  
9 plaintiff . . . to provide a defendant with some indication of the loss  
10 and the casual connection that the plaintiff has in mind." *Dura*  
11 *Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005).

12 Here, plaintiffs have provided such an indication. They allege that  
13 the loss was, at a minimum, the dollars siphoned out of the corpus  
14 for undisclosed purposes of no benefit to investors. Every dollar  
15 lifted out of the corpus reduced the net assets of the fund and  
16 reduced its ability to earn income. Defendants are correct that  
17 there was no drop in share value after the truth was revealed.  
18 That is because the underlying portfolio and its net asset value was  
19 the same just before and just after. Dressed up as fees, cash was  
20 being misappropriated from the common fund. The fees were not  
21 used for their ostensible purposes but were diverted to support  
22 ongoing distribution. The true price of admission to the fund was  
23 greater than was represented. At least that is the allegation. It is  
24 sufficient at this stage.

25 *Siemers*, 2007 WL 760750, at \*14. The complaint in *Siemers* is substantially similar to the  
26 present complaint with regards to loss causation. The reasoning in *Siemers* still applies.  
27 The pleadings are sufficient.

28 The complaint states a claim under Rule 10b-5 with adequate particularity. Accordingly,  
defendants' motion to dismiss this claim is denied.

### CONCLUSION

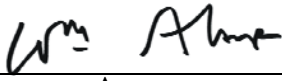
This order finds that plaintiffs were on inquiry notice no later than December 2005 —  
more than two years before the filing of this action. Plaintiffs' *individual* claims were tolled by  
the filing of *Siemers*. The *class* claims, however, were not tolled by the filing of *Siemers*.  
Accordingly, plaintiffs may continue in this action as individuals but the class allegations are  
dismissed. Because the class allegations are untimely, they are dismissed without leave to



1 amend. The complaint otherwise states a valid claim for relief. Defendants' motion to dismiss  
2 plaintiffs' individual claims is thus **DENIED**.

3  
4 **IT IS SO ORDERED.**

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6 Dated: August 19, 2009.

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WILLIAM ALSUP  
UNITED STATES DISTRICT JUDGE